

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 00-0086
STATE GROSS RETAIL AND USE TAXES
For Years 1995 and 1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales / Use Tax – Assessment: Best Information Available (BIA) Method Used to Determine Taxpayer's Sales and Use Tax Liabilities

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2; IC 6-2.5-3-6(b), (c); IC 6-2.5-4-1(b); IC 6-2.5-6 et seq.; IC 6-8.1-5-1(a); IC 6-8.1-5-1(b); IC 6-8.1-5-4(a); 45 IAC 2.2-2-2.

Taxpayer protests the auditor's BIA method of calculating gross retail income and the auditor's BIA determination of the rate of markup audit used in calculating taxable sales.

II. Request for Abatement of 10% Negligence Penalty: Penalty Abatement

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(c).

Taxpayer protests the assessment of the 10% negligence penalty and requests that the penalty be abated.

III. Request for Abatement of Interest: Interest Abatement

Authority: IC 6-8.1-10-1; IC 6-8.1-10-1(a).

Taxpayer protests the imposition of interest on assessed taxes and requests that the interest that has accumulated on those assessed taxes be abated.

DISCUSSION

Taxpayer operated a computer consulting and retail business in Scottsburg, Indiana. Taxpayer was the only shareholder of that business. When taxpayer's business began, it specialized in selling computer hardware and software. Following its first business year,

taxpayer changed his business goals and concentrated on providing software and consulting services. Taxpayer's business ceased operation in September of 1997.

I. Sales / Use Tax – Assessment: Best Information Available (BIA) Methods Used to Determine Taxpayer's Sales and Use Tax Liabilities

Taxpayer admits that he "may" owe back taxes. (Taxpayer Letter, Jan. 28, 2000)
However, taxpayer protests the means by which audit determined the amount of state gross retail and use tax owed. Taxpayer disagrees with both audit's determination of the base amount of his gross retail income and with audit's determination that 140.65% is an accurate and appropriate retail markup used to determine that gross retail income. Taxpayer contends that his computer business, located in a small town but competing with nearby large discount merchants, never generated the quantity of sales estimated by the auditor. Further, taxpayer contends that the rate of retail markup determined by audit, 140.65%, is a wholly unrealistic estimate of the actual retail markup that a business such as his could have used. Finally, taxpayer contends that audit failed to consider that his business never generated a substantial number of retail sales but that it concentrated, especially in the last year of its operation, in providing consulting services and repairing computer software.

The audit was conducted in the absence of taxpayer's sales records. No business records listing any taxable sales for sales tax purposes were provided to the auditor for the periods covered by the audit. Instead the auditor relied on copies of income tax returns to determine taxpayer's sales figures. However, those income tax returns listed only total sales and did not provide a detailed listing of sales subject to sales tax. As taxpayer admitted (and in fact serves as one of the basis for his protest) some of taxpayer's income revenue probably consisted exclusively of labor or consulting fees.

Taxpayer's income tax returns for fiscal years ending 9/30/95 and 9/30/96 listed amounts for the costs of goods sold. The return for 1997 did not. The auditor proposed an assessment for 1995 and 1996 but not for 1997 because, from the available records, it was determined that taxpayer had no taxable sales in 1997 but received only consulting fees. 1997 was the last year taxpayer was in business.

The auditor reconstructed taxable sales based upon taxpayer's yearly purchases. The auditor consulted "Industry Norms & Key Business Ratios," Desk Top Edition 1998-1999 by Dun & Bradstreet, and used the statistics, based on SIC Code 5734 – "Computer and Software Stores," to determine a normal markup on retail sales of goods in the computer industry. Based on the relevant average percentages for net sales and gross profit, the audit calculated a markup on purchases amounting to 140.65%. Audit used that markup rate times the business's purchases of goods for resale to determine the total sales price for the goods.

It was necessary for audit to extrapolate the information provided by fiscal year to determine sales tax by calendar year and to account for months in which no information was available.

Taxpayer claimed to have accrued no use tax liability. However, audit's examination of taxpayer's purchase records and income tax returns revealed items which led to a contrary determination. Because taxpayer had no purchase invoices available for review, the audit proposed an adjustment to use tax based on items purchased during the audit period. These items included fixed assets listed on taxpayer's depreciation schedule for 1995. No fixed assets were purchased in the other audited years. The audit also proposed a use tax assessment based on the amounts shown for various accounts on the taxpayer's income tax returns.

Pursuant to IC 6-2.5-2-1, an excise tax known as the state gross retail tax is imposed on retail transactions made in Indiana unless a valid exemption is applicable. The imposition of gross retail tax is triggered by the occurrence of a retail transaction in which a person, in the ordinary course of his business, acquires tangible personal property for the purpose of resale and transfers that property to another person for consideration. IC 6-2.5-4-1(b). Under 45 IAC 2.2-2-2, the state gross retail tax is paid by the customer but the retail merchant acts as an agent for the state of Indiana and is responsible for collecting the sales tax. Acting as the state's agent, the seller is not only responsible for collecting but must hold the tax and pay it over to the state periodically. *See* IC 6-2.5-6 et seq.

A complimentary use tax is imposed on transactions that occur outside of Indiana that would be taxable if they occurred within Indiana, but only if the property acquired is either stored, used, or consumed inside Indiana. IC 6-2.5-3-2. Under IC 6-2.5-3-6(b), (c), the person who stored, used, or consumed the property is personally liable for the use tax and may either pay the tax to the eligible merchant who sold the property or pay the use tax directly to the state of Indiana.

In plain, straightforward language, IC 6-8.1-5-1(a), authorizes the Department, if it reasonably believes that a taxpayer has not reported the proper amount of tax due, to make a proposed assessment of unpaid tax on the basis of the best information available to the department. The fact that taxpayer failed to remit any sales or use tax for the three years of the audit and ignored all but one of the Department's BIA billings could have led the Department to "reasonably believe[] that a person [had] not reported the proper amount of tax due." IC 6-8.1-5-1(a). Audit's BIA determinations were made necessary by taxpayer's failure to maintain or provide pertinent information, records, or past invoices.

Under IC 6-8.1-5-4(a), "Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." The records referred to "include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and cancelled checks."

The record would indicate that the auditor employed, in a conscientious and professional manner, the best available records and source materials to produce the BIA assessment. Taxpayer was repeatedly invited to contribute additional substantive information or to rebut the audit's conclusions with concrete information. Taxpayer declined to do so.

The Department's proposed assessment, under IC 6-8.1-5-1(b), is deemed to be "prima facie evidence that the department's claim for the unpaid tax is valid." That same section of the Indiana Code goes on to state that "the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In attempting to rebut the assessment, taxpayer stated that audit's determinations and methods were "grossly misrepresentat[ive]," inaccurate and based upon standards that were inapplicable to "rural America." (Taxpayer Letters, Dec. 30, 1999; Jan. 28, 2000). Taxpayer stated that his own investigation found that small computer shops mark up their merchandise approximately 12% as opposed to the substantially higher percentage determined by audit. (Taxpayer Letter, May 14, 2000). Taxpayer provided no information to substantiate that estimate. Furthermore, taxpayer has failed to provide any evidence which would assist the Department in making an alternative determination of taxpayer's liabilities.

By failing to present any viable or substantive evidence, the taxpayer has failed to meet his burden of proof, imposed under IC 6-8.1-5-1(b), to rebut the presumptive validity afforded the Department's proposed use and sales tax assessments.

FINDING

Taxpayer's protest is respectfully denied.

II. Request for Abatement of 10% Negligence Penalty: Penalty Abatement

Taxpayer protests the imposition of the 10% negligence penalty and requests that the penalty, assessed pursuant to IC 6-8.1-10-2.1, be abated. Under IC 6-8.1-10-2.1(d), the Department is empowered to waive the 10% negligence penalty if taxpayer can establish that his failure to pay the deficiency was due to reasonable cause and not due to willful neglect. Under 45 IAC 15-11-2(c), in order to establish reasonable cause, the taxpayer must demonstrate that he exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. Ignorance of the listed tax laws, rules, and/or regulations is treated as negligence.

Factors which may be considered to determine reasonable cause include the nature of the tax involved, judicial precedents set by Indiana courts, judicial precedents established in jurisdictions outside Indiana, published department instructions, information bulletins, letters of findings, rulings, and letters of advice. 45 IAC 15-11-2(c).

Taxpayer states that his pertinent financial business records were lost. However, the loss of these records does not explain taxpayer's failure to respond to or pay the BIA assessments levied during the years at issue. Taxpayer has offered no other explanation for his failure to pay sales or use taxes. Taxpayer has furnished no substantive, statutory, or factual basis upon which the Department can justifiably be expected to find a reasonable cause for taxpayer's failure pay the assessed tax deficiency.

FINDING

Taxpayer's protest is respectfully denied.

III. Request for Abatement of Interest: Interest Abatement

Taxpayer protests the imposition of interest on assessed taxes and requests that the interest that has accumulated on those assessed taxes be abated. Under IC 6-8.1-10-1(a), if a person incurs a deficiency upon a determination by the department, "the person *is* subject" to interest on the nonpayment.

The Department has no discretion regarding the imposition of interest. Under IC 6-8.1-10-1, interest is not abated for any reason.

FINDING

Taxpayer's protest and request for abatement is respectfully denied.